

**STATE OF HAWAII
DEFERRED COMPENSATION PLAN
BOARD OF TRUSTEES**

**OPEN SESSION MINUTES
SEMI-ANNUAL MEETING
MEETING # 362**

Date: May 10, 2012

Place: Hawaii Prince Hotel
Captain's Room
100 Holomoana Street
Honolulu, HI 96815

Present: Wayne Chu, Chairperson
Kalbert Young, Ex-Officio Member
Scott Kami, Employee Member
Wesley Machida, Employee Member
Neal Miyahira, Employee Member
Dennis Vanairsdale, Employee Member

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Troy Saharic, Mercer Investment Consulting
David Williams, Mercer Investment Consulting
Melody Takacs, Plan Administrator Staff (ING)/Honolulu Office
Grace Baracao, Plan Administrator Staff (ING)/Honolulu Office
Jeanne Kanai, Plan Administrator Staff (ING)/Honolulu Office
Tom Kalili, Plan Administrator Staff (ING)/Honolulu Office
Kristine Matthews, Communications Manager (ING-Boston Office)
Brian Merrick, Plan Administrator Staff (ING-Boston Office)
Bill Owens, Investment Advisory Services (ING-Boston Office)
Molly Ono, INVESCO
Todd Egger, INVESCO
Jennifer Gilmore, INVESCO
Michael Bowman, Capital Research (EuroPacific)
Steve Caruthers, Capital Research (EuroPacific)
Tom Smythe, New York Life (Mainstay)
Michael Chandra., PIMCO
Joan Larsen, Prudential
Cheryl Lynch, Jennison Associates
Sue Bonfeld, Wellington Management Co.
Cris Hernandez, Wellington Management Co.

State of Hawaii Island Savings Plan

Minutes # 362

May 10, 2012

Page 2

Lisa Rosenthal, Victory
Ed McGettigan, Vanguard
Tom Atchison, Vanguard
Valerie Miller, Vanguard
Peter Whitlock, Century Capital
Robert Atwell, Harbor
James Carville, BlackRock
Eric Bildt, TD Ameritrade
Lisa Hoxha, Great West Retirement Services

Absent: Barbara Krieg, Ex-Officio Member

Call to

Order: There being a quorum present, Chairperson Chu called the meeting to order at 9:02 a.m.

Agenda: The agenda for this meeting was filed with the Office of the Lieutenant Governor, as required by Hawaii Revised Statutes section 92-7.

Chairperson Chu welcomed all attendees and opened with introductions from the Board members, Board and ING staff, and Mercer.

Agenda

Item # 1: Annual Report from ING

Presenting from ING are Mr. Brian Merrick, Ms. Kristine Matthews, Ms. Melody Takacs, and Mr. Bill Owens.

Mr. Merrick reported on the service review highlights for the partial Plan Year period ending March 31, 2012:

- Plan assets increased by \$50 million since June 30, 2011, to \$1.6 billion. Looking for more opportunities to grow the assets within the Plan;
- Average Plan balance was approximately \$58,570;
- Total deposits (contributions) were \$59 million which include vacation payouts and rollovers-in;
- Total distributions were \$59 million.
- Recap of the Accomplishments:
 - The Plan received 2 awards at the NAGDCA conference in September 2011, for Plan Design and Administration and for National Save For Retirement Week activities;
 - The Personal Evaluation campaign was conducted in October 2011, and 17,000+ statements were sent out to those participants with salary information on file;

- The Benefits Fair in Hilo in October 2011 and yesterday's Fair were successfully held;
- Availability of mobile applications for phones were rolled out and there are some participants who have already started to use the mobile phone applications;

Ms. Takacs provide the Local Office Updates:

- Local office held 429 group meetings, with attendance of over 2,400 participants;
- Over 5,000 one-on-one consultations were held;
- More than 500 walk-ins and 2,700 calls
- Intake of 313 new enrollments;
- A new Plan consultant was hired in January 2012. Ms. Takacs introduced Mr. Tom Kalili, who resides in Hilo and will service primarily the Big Island.

Ms. Matthews reported on the highlights of the Communications Campaigns:

- ING partnered with SMS Research to conduct a Customer service satisfaction survey to capture the voice of the customer.
 - Goals were to measure the level of customer satisfaction.
 - Identify areas of unfulfilled need and improvement.
 - Contacted 800 participants.
 - Will be used as a benchmark.
 - Report and analysis at an upcoming meeting.
- Benefits Fair on May 9, 2012
 - Attendance exceeded estimated projections.
 - Ms. Matthews thanked the Board and the investment fund managers for attending the Fair to make it a successful event.
 - Ms. Takacs reported that a special flyer for the Fair was created for DOE employees to increase education and awareness on the comparisons between the 403b and the 457 plans. In evaluating the past participation of DOE employees, the last Fair on Oahu attracted 67 DOE employees out of a total of 934 attendees for a 7% attendance rate; and yesterday's Fair attracted 55 DOE employees out of 598 attendees for an increased attendance rate of 9%. Flyers were delivered to schools in the Fair site area. Received numerous positive feedback and

enrollments by DOE employees (teachers) at the Fair.

- Educational campaign on diversification.
 - Found that 54% of Plan participants are invested in only 1 investment option, the Stable Value Fund.
 - Developed a "colorful way to diversify" brochure that prompted attendees to visit all the investment fund managers to have the brochure stamped. A completed card could be turned in for a prize.
 - 560 cards were given out; 382 returned the completed stamped card. There was a 68% response rate.
 - The objective was to encourage attendees to talk to the investment fund managers to learn about the options.
- Fund of Funds campaign.
 - To assist the Board on obtaining feedback on the Fund of Funds concept, initiated this campaign.
 - Arranged for a mini focus group with a prepared scripted presentation at the end of several workshops at the Fair, and conducted a mini survey for participants who listened to the presentation to determine participant interest.
 - Report of the analysis will be prepared and presented at an upcoming meeting.

Mr. Merrick provided information on the Roth 457 option:

- Legislation was prompted as a result of the Small Business Jobs Act of 2010; became effective in January 2011;
- Option would allow for after-tax contributions including payroll contributions, rollovers, in-plan conversions of pre-tax monies;
- Contributions coming in on a tax-free basis and the earnings could be distributed tax-free on a qualified basis;
- Plan sponsor requirements: to update the Plan document to add provision to allow participants to make ongoing Roth contributions in order to allow in-plan conversions.
- Develop communications: on educating participants; presentations will be critical; training of staff will be needed.
- Implementing would require working with payroll providers; need to record keep separately, track individual timelines to determine what distributions would qualify.
- ING has 72 governmental clients that have implemented Roth 457, that includes 4 state plans and 2 state plans that are in the process

- of implementing this option.
- ING has a state client that added the option in 2008; they have 2600+ participants contributing, which is about 8.5% of the eligible population.
- Has seen more of a younger population using this option.
- Mr. Merrick further explained that participants can access the Roth account upon distribution but it is subject to whether the distribution qualifies for the beneficial tax treatment.
- Mr. Merrick explained some of the coordination that is needed to track the multiple payroll sources. Implementation period could be anywhere between 3 to 6 months.

Mr. Merrick provided the following updates:

- Technology Enhancements
 - Changes to Website include dashboard viewing of accounts, see balances and rate of returns; and hotlinks available
 - P-web mobile which is an application that can be downloaded on their phones.
 - Development of games to encourage saving for retirement due to the number of gamers.
 - Changes to the plan sponsors pages.

Mr. Owens provided Investment Advice program updates:

- From speaking with participants at the Fair, many participants relayed that they were not using the advice program was because many were only invested in the Stable Value Fund.
- Communicated to participants about accessing the investment advice tools and show the importance of diversification and to see the value of their account if they continue to stay where they are. Encouraged participants to go to the Personal Online Advisor to see what the income levels could be.
- Overall usage at 15+%; about 1,800+ members in the Professional Account Manager program, that results in a participation rate of about 7%.
- As a result of the October 2011 campaign, increase usage of 8.7%.

Agenda

Item # 2:

Investment Performance Evaluation Report from Mercer

- a. Economic and Capital Market Environment

Mr. Saharic provided the following report:

- Active managers did well; saw double digit gains in 1Q 2012;
- The non-US sector saw gains halted in 1Q2012 with some exceptions,
- Fixed Income markets had marginal profits because Treasuries were off;
- Global REITS did well during the quarter;
- US economy continued to sluggishly move along;
- Growth was mainly seen in Asia and Emerging markets;
- Favor equities over fixed income; some observations were that plans have been looking for low volatility strategies;
- Emerging markets did well; and valuations on Emerging markets look attractive;
- TIPS were in negative yield territory, so not so attractive now; so see managers moving to more high yield/opportunistic sectors.

Mr. Williams provided the following report on the Plan:

- Line-up of the investment options will change when the new investment options are added;
- Manager update: MainStay product had a guideline change to remove a 5% cap maximum limitation in any one stock and replace with the greater of 5% market; as a result of the Apple stock growing to 6-7% of the Russell 1000 growth. Mercer supports the flexibility around the benchmark weight;
- Contracts for the Emerging markets and Diversified Inflation Hedge options have been signed; staff is in the process of completing the contract negotiations for the International Large Cap Value option;
- Stable Value Fund has decreased in assets due to strong equity market. Transactional impact was not much, the decrease has been more of a market movement change;
- Plan assets totaled \$1.6 billion, about a \$82 million increase from the last quarter;
- Average account balance of \$59,000 per participant.
- Lifecycle Portfolios were behind in the 1-, 3- year periods; passive managers did well for the 3 and 5 year periods;
- Harbor Funds had a good rebound over the year; 3-year numbers have improved;
- Century Funds saw a nice rally;
- Victory has struggled over the last 18 months;
- Lifecycle Portfolios had a strong performance over the last 3

- months;
- Index Funds tracked nicely in a difficult environment;
 - Stable Value Fund had a strong quarter, 1-, 3-, 5-year numbers were strong; market to book ratio is at 108% as of March 2012;
 - PIMCO performed well over the quarter, long-term performance still favorable;
 - Vanguard in line with the benchmark over the quarter;
 - Wellington Research had strong performance;
 - Victory had good performance over the quarter;
 - MainStay had a strong quarter, long-term numbers are favorable;
 - Harbor Fund had a slight lag in the quarter due to overweight in energy;
 - Century behind in the benchmark for 3-, 5-year, but relative to peers have done okay;
 - EuroPacific is ahead of benchmark;
 - Average expense ratio has been at 32 basis points; taking opportunities to lower the expenses ratio is a focus and makes the Plan attractive.

Mr. Williams noted that the asset allocation for the 2045 and 2055 Funds is essentially the same, and do not see much difference between off the shelf funds and custom funds; in the process of doing the annual update and will not see much changes with these funds, even with the addition of the new funds.

Chairperson Chu acknowledged INVESCO, Wellington, PIMCO, and New York Life for sponsoring today's meeting, and called a 15-minute break at 10:07 a.m. The meeting resumed at 10:20 a.m.

Chairman Chu thanked the investment fund managers for working with Mr. Saharic to provide the Board with the education that is necessary to understand the investment management industry and current investment trends in the market.

Agenda

Item # 3: Panel Presentation # 2 on Stable Value Fund Management Overview: Prudential/Jennison, INVESCO, and PIMCO.

Presenters: Cheryl Lynch from Jennison; Michael Chandra from PIMCO, Jennifer Gilmore from INVESCO; and Joan Larsen from Prudential.

Ms. Lynch acknowledged Ms. Molly Ono and Todd Egger from INVESCO who are also in attendance today. Ms. Lynch stated that the panel will be presenting on the trends in stable value including the fixed income investments and wrap provider market.

Ms. Lynch provided an overview on the stable value portfolio which should seek to achieve safety and liquidity over a full market cycle. Jennison has a conservative approach focus on high quality bias. Its focus is to minimize downside risk. Ms. Lynch explained what opportunities Jennison looks for, and how they look for value.

Mr. Chandra stated that stable value remains popular among defined contribution plans, and that the allocation of assets remains higher in the Hawaii Plan. He sees that the stable value fund will remain a critical component in participant portfolios, and explained the reasons why the stable value fund remains popular what the stable value will look like over the next 10 years.

He explained that stable value has provided consistent returns over the last 10 years with low level of volatility. Core bonds have generated returns of 9% annualized over the last 30 years, mainly driven on the back of declining interest rates.

He noted that stable value fund managers will need to work harder to deliver attractive returns going forward. Fixed income managers will need to pay attention to those areas of diverging growth when allocating portfolios, to combat areas of slower growth. Traditional patterns of indebtedness have changed remarkably; emerging markets countries have shifted downward in leverage and have been able to grow their GDPs faster than an increase in the amount of debt outstanding, thereby reducing their balance sheet leverage. Finding that managers need to relook at where the sources of risk free return are in the global economy.

With declining interest rates, some areas of returns in the fixed income markets could be found in such sectors as corporate bonds, hi-yields, municipal bonds, certain asset-backed securities. He noted that investors need to widen the gap for opportunities, and it seems like a good time to reallocate a portion of the portfolios to emerging markets.

Ms. Gilmore explained the stable value wrap environment and the reasons for the changes. The wrap providers allow for the gains and losses to be amortized that occur in the fixed income portfolio over time, and guarantee the 0% floor for principal preservation.

In 2008, began to see that market value of assets was not sufficient to cover the book values. Rates were low, and banks started looking at making changes to the wrap business since wraps were not part of their core business. Banks were choosing to exit the business; on the front line were UBS and Rabobank. INVESCO has been working on transition plans; has seen and working with new entrants to alleviate the capacity concerns. However, some constraints from the

new entrants are that they are requiring that they perform the asset management and have stringent investment guidelines for the underlying assets. So, these wrap providers are focusing on terms and conditions that would mitigate and control risk and limit interest rate duration.

Ms. Larsen explained that Prudential has \$48 billion in wrap, and is committed to this industry to provide wrap capacity for stable value products.

Agenda

Item # 4: Panel Presentation # 2 on Defined Contribution Plan Participant Trends: Vanguard

Presenters: Ed McGettigan

Mr. McGettigan provided some information and data around the defined contribution plans. With the bear market starting in 2007, the markets dipped in 2008 and have come back. Participant behavior plays out from what happened in the markets. Studies of defined contribution plans that Vanguard record keeps show that average participation rates are about 74%, and when you look at all plans in total as one plan the participation rate is about 68%. One-third of all participants are not taking advantage of retirement savings through a defined contribution plan.

Younger workers with lower incomes or workers with shorter tenure tend to have the lowest participation. Average deferral rate is about 6.8%. There is a group of strong savers, but there is also a group of not strong savers, about 30%, who are saving less than 4%.

For plans with employer matches, the average aggregate contribution rate is about 9.7%, and the median rate is 8.8%; ideal range should be at around 12% to 15%.

Plans have increased usage of the automatic enrollment option where participation is mandatory unless opt out. 75% of plans have automatic deferral increases over time; 99% have a balanced default strategy with 92% having target date funds. Mr. McGettigan noted that plans have seen an impact on participation rates with automatic enrollment and the option has helped participants save for retirement.

Mr. McGettigan provided data and illustrations on changes within participant account balances between the end of 2007 and end of 2010, and how the allocations were distributed and invested within participant accounts. He also provided data showing participant trading activity and behavior during 2007 to 2010 which revealed that about 73% of participants who didn't trade, noting perhaps it's a benefit of inertia.

Agenda

Item # 5: Panel Presentation # 3 on Trends in Small Cap Equity Management: Harbor Funds and Century Capital Management

Presenters: Robert Atwell and Peter Whitlock

Mr. Atwell talked about the general trends within the small cap equity space. Small cap equities have rallied this quarter. Since September 2011, there has been a lower quality rally and the more global cyclical sensitive sectors have contributed to the drive in the market rally. If volatility starts to rise, could see a shift towards higher quality and higher market value.

Mr. Whitlock presented correlation trends in the markets. With a decrease in the VIX index and the narrowing of the credit spreads, this has provided a positive environment for small cap stocks. Mr. Whitlock explained some of the reasons for the lower relative out performance of small cap active managers and some correlation points. He provided some contributing factors leading to the trend like the evolution of ETFs (exchange traded funds).

Agenda

Item # 6: Panel Presentation # 3 on Global Equity Portfolios: American Funds

Presenters: Mr. Michael Bowman and Steve Caruthers

Mr. Bowman and Mr. Caruthers explained that global investing allows you to invest throughout the world, versus international investing which limits to investing only internationally, places outside the U.S. An exercise was held for the Board in choosing companies that would do best for an international portfolio.

Agenda

Item # 7: Other Business/Announcements

- a. Approval of Minutes Nos. 359 and 360

A motion was made by Trustee Young and seconded by Trustee Machida to approve Minutes No. 359 and 360, as is. The motion passed unanimously.

- b. Presentation of Resolution to Outgoing Trustee Vanairsdale

Chairperson Chu announced that Trustee Vanairsdale plans to retire soon and will be leaving the Board. A lei was presented and Trustee Miyahira presented a resolution to acknowledge his service to the Board. Trustee Vanairsdale provided some closing remarks.

State of Hawaii Island Savings Plan
Minutes # 362
May 10, 2012
Page 11

Chairperson Chu closed by acknowledging INVESCO, Wellington, PIMCO and New York Life for sponsoring today's lunch, and adjourned the meeting at 12:10 p.m.

(Note: Signed copy on file.)